

Message Text

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ACTION NEA-10

INFO OCT-01 EUR-12 ISO-00 AID-05 CIAE-00 COME-00 EB-07

FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03

SP-02 CIEP-01 LAB-04 SIL-01 OMB-01 AGR-05 ABF-01 FS-01

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FM AMEMBASSY NEW DELHI

TO SECSTATE WASHDC 1463

INFO AMEMBASSY ISLAMABAD

AMEMBASSY KATHMANDU

AMEMBASSY LONDON

AMCONSUL BOMBAY

AMCONSUL CALCUTTA

AMCONSUL MADRAS

C O N F I D E N T I A L NEW DELHI 13082

PASS TREASURY AND FEDERAL RESERVE BOARD

E.O. 11652: E.O. 11652: GDS

TAGS: EFIN, IN

SUBJ: RUPEE/POUND DELINK

REF: NEW DELHI 12917

1. AS REPORTED REFTTEL, THE GOI DELINKED THE INDIAN RUPEE FROM THE POUND STERLING EFFECTIVE SEPTEMBER 25 AND WILL NOW DETERMINE THE EXCHANGE RATE OF THE RUPEE VIS-A-VIS A WEIGHTED AVERAGE OF A BASKET OF CURRENCIES. THIS WILL WORK AS FOLLOWS: THE RESERVE BANK OF INDIA (RBI) WILL CALCULATE EVERY DAY THE VALUE OF THE RUPEE WITH RESPECT TO EACH CURRENCY IN THE BASKET, BUT WILL ANNOUNCE THE EXCHANGE RATE OF THE RUPEE IN TERMS OF STERLING. THE RBI'S SPOT BUYING AND SELLING RATE FOR
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POUNDS HAS BEEN SO FIXED AS TO YIELD A MIDDLE RATE OF RS.

18.3084, WITH THE BUYING RATE FOR STERLINE SET AT 5.4769 POUNDS PER RS. 100 (CORRESPONDING TO RS. 18.26 PER POUND) AND THE SELLING RATE SET NAT 5.4471 POUNDS PER RS. 100 (CORRESPONDING TO RS. 18.36 POUND); THE VALUE OF THE RUPEE WILL BE MAINTAINED IN FUTURE WITHIN A BAND OF 2.25 PERCENT ON EITHER SIDE OF THE MIDDLE RATE IN TERMS OF THE MULTI-CURRENCY BASKET. A DAILY CHANGE IN THE RUPEE/POUND RELATIONSHIP WOULD NOT ONLY BE CUMBERSOME BUT ALSO CREATE NEEDLESS UNCERTAINTIES IN THE MINDS OF EXPORTERS.

2. THIS MOVE BY THE GOI DID NOT COME AS A SURPRISE. IN A CONVERSATION WITH RBI DEPUTY GOVERNOR HAZARI, HE TOLD FINATT THAT AS THE POUND FELL AND THE RUPEE IN TERMS OF DOLLARS REACHED ONE PLATEAU AFTER ANOTHER (I.E. RS. 7.5 TO THE DOLLAR, RS. 8.0 TO THE DOLLAR, RS. 8.5 TO THE DOLLAR AND FINALLY RS. 9 TO THE DOLLAR), A DECISION WAS FINALLY MADE TO TAKE ACTION.

3. THE RUPEE HAD BEEN DEVALUED BY 30 PERCENT SINCE DECEMBER 1971. WHILE INITIALLY THIS WAS SEEN AS AIDING EXPORTS, I.E., MAKING THEM MORE PRICE COMPETITIVE, THE EFFECT ON IMPORTS IS NOW SEEN AS OF MORE IMPORTANCE. IMPORTS ARE BASICALLY PRICE INELASTIC AND THUS THE PRICE OF NECESSARY INDUSTRIAL INPUTS ARE RISING WHILE DEMAND REMAINED UNAFFECTED. WITH A CONCERTED EFFORT TO CHECK INFLATION IN INDIA, THE GOI DECIDED THAT IT WAS TIME TO CHECK THE INFLATIONARY IMPACT GENERATED BY RISING IMPORT COSTS. THE DECISION WAS ALSO TAKEN IN THE HOPE THAT THE NEW EXCHANGE ARRANGEMENT WOULD BRING ABOUT A GREATER DEGREE OF STABILITY TO INDIA'S EXCHANGE RATE AND INTERNATIONAL TRANSACTIONS.

4. THE GOI IS UNLIKELY TO ANNOUNCE THE COMPOSITION OF THE BASKET. THE SELECTION OF MAJOR INTERNATIONAL CURRENCY UNITS AND THE WEIGHTS TO BE ASSIGNED TO THEM WAS LEFT TO THE DISCRETION OF THE RESERVE BANK OF INDIA, SUBJECT TO THE APPROVAL OF THE CENTRAL GOVERNMENT. HOWEVER, IT IS ASSUMED THAT THE DOLLAR, POUND, DM AND YEN WAS INCLUDED. GOVERNOR HAZARI SAID THAT ONLY 4 OR 5 INDIVIDUALS IN THE GOI KNOW THE MAKEUP OF THE BASKET. THIS WILL SERVE AS A CHECK ON SPECULATORS AND WILL GIVE THE GOI FLEXIBILITY IN CHANGING THE COMPOSITION OF THE BASKET AS THE NEED ARISES.

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5. IN LOOKING AT THE OPTIONS OPEN TO THE GOI, A LINK TO THE DOLLAR WAS RULED OUT BECAUSE OF ITS CURRENT STRENGTH AND POLITICAL CONSIDERATIONS. A LINK TO THE SDR WAS VIEWED AS NOT GIVING THE PROPER WEIGHT TO CURRENCIES IN TERMS OF INDIA'S TRADE. WHILE SOME INDIAN ECONOMISTS FAVORED A CONTINUED TIE TO THE POUND, EVERYONE REJECTED A FLOATING RUPEE. HAZARI NOTED THAT INDIA HAS BEEN MOVING OUT OF STERLING STEADILY SINCE 1971 WITH THE RBI ONLY

HOLDING WORKING BALANCES.

WHILE COMMERCIAL BANKS TAKE IN QUITE A BIT OF STERLING, THIS IS
HANDED OVER TO THE RBI, WHICH THEN QUICKLY SELLS THE POUNDS
AND PURCHASES CURRENCIES SUCH AS DM, SWISS FRANCS, AND DOLLARS.

6. IN ACUTAL FACT THE INDIAN ACTION CHANGES THEIR EXCHANGE RATE
POLICY

VERY LITTLE. CHANGES IN THE MIDDLE RATE WILL NOW BE DETERMINED
BY THE CHANGE IN VALUE OF A BASKET OF CURRENCIES RATHER THAN
SOLELY THE POUND. ONLY WHEN THE RUPEE REACHES THE 2.5 PERCENT
MARGIN ON EITHER SIDE OF THE MIDDLE RATE WILL THE MIDDLE RATE BE
CHANGED IN TERMS OF THE CURRENCY BASKET. THE NEW BUYING AND
SELLING RATES ARE VERY CLOSE TO THE NEW MIDDLE RATE, I.E.,
ONLY 5 PAISA ABOVE AND BELOW. THERE WILL BE NO CHANGE IN THE
METHOD OF USING THE DOLLAR/STERLING CROSS RATE TO DETERMINE
THE DOLLAR/RUPEE RATE.
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